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China's Most-Favored-Nation Status: U.S. Wheat Exports

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SUMMARY

By June 3, 1994, President Clinton must determine whether or not to recommend to Congress a one-year extension of his Jackson-Vanik waiver authority, in effect extending most-favored-nation (MFN)[1] trading status to China for another year. The media are reporting that the President has not yet decided whether he will ask for an extension, and that he may also be deliberating over whether or not to attach conditions to a recommendation for approval.

The President's action on MFN this year will be determined by the conditions set forward in his Executive order of May 1993. In that order, he placed human rights conditions on China's eligibility to be granted MFN status this year. In addition, several Members of Congress have introduced bills that would prohibit the President from recommending a continuation of China's waiver, and thus a continuation of MFN status, unless the President reports to Congress that China has made significant progress in human rights and the international security area. One bill would block extension of MFN unless the President determines that China has stopped manipulating the dollar/yuan exchange rate; and another bill would terminate MFN status under any circumstances and would prohibit restoring it. (For more information on China's MFN status, see CRS issue brief 92094, *Most-Favored-Nation Status of the People's Republic of China*.)

[1] MFN (nondiscriminatory) status means that trade privileges or concessions that the United States grants to any nation would automatically apply to the MFN country.

Some trade specialists believe that China, if denied MFN this year, might retaliate by prohibiting certain imports from the United States. While China is a major market for a wide array of American products, it is especially important for agriculture in general, and wheat in particular. In recent years, wheat has amounted to between 60 and 92 percent of China's agricultural imports from the United States. China is often among the largest importers of U.S. wheat, buying as much as one-fifth of all U.S. wheat exports in some years. It was recently revealed, however, that China is releasing its large grain stocks onto the market; this is expected to dampen its wheat purchases from the United States in the near term. As Congress debates whether it should grant, deny, modify, or place restrictions on the extension of MFN status to China, it may be asked to consider the potential impact on the U.S. wheat industry.

BACKGROUND

China became a major U.S. agricultural export market in 1987, when it broke into the ranks of the top 20 importers of farm products. As table 1 below shows, it has remained a significant importer ever since. However, its rank has fluctuated markedly from one year to the next, and has slipped each year since 1989.

Table 1: U.S. Agricultural Exports to China, 1986-1992

Calendar Year	Value (in $ million)	Rank
1986	58	60
1987	362	19
1988	759	13
1989	1,435	8
1990	814	11
1991	722	12
1992	545	15
1993	376	21

SOURCE: U.S. Department of Agriculture. Economic Research Service. Foreign Agricultural Trade of the United States. Washington, D.C. Various Issues.

China purchases a broad array of U.S. agricultural products, including grains, soybeans, cotton, livestock, and horticultural products, and even wine and tobacco. Wheat, however, accounts for a large share of U.S. agricultural exports to China. In 1992, wheat accounted for 50 percent of the value of U.S. exports to China, down from 92 percent in 1988. A major portion of U.S. wheat

exports to China have been subsidized through the U.S. Department of Agriculture's (USDA) Export Enhancement Program (EEP), and negotiations to extend USDA export credits to China are underway. (For more information on EEP, see CRS report 91-861 ENR, *If the Export Enhancement Program Were Eliminated.*)

According to USDA, the Chinese typically prefer to buy high quality, high protein wheats, such as hard red spring or winter wheat, which they mill for flour for bread and other baked goods.

U.S. wheat exports often make up a large portion of the market share in China; for example, U.S. wheat exports held more than one-third of China's market in recent years. However, on a year-to-year basis, both the quantity of wheat exports and the U.S. market share of China's wheat market have fluctuated significantly. This would appear to support the claims by some agricultural economists that the United States is a residual supplier of wheat to China.

In 1992, China disclosed that it had large grain reserves--enough to cover 14.2 months of consumption (the United Nations Food and Agriculture Organization recommends that countries maintain 2 months of reserves). Because of these stocks, accumulated partly for strategic purposes prior to the breakup of the Soviet Union, China purchased significantly less wheat from the United States last year, and its demand for U.S. wheat may remain dampened for another year or two, according to USDA economists.

Table 2: U.S. Wheat Exports to China, 1987-1992

Fiscal Year	Wheat Sales (in million $)	Rank
1987	65	13
1988	525	2
1989	1,225	1
1990	544	2
1991	330	2
1992	370	4
1993	238	4

SOURCE: U.S. Department of Agriculture. Economic Research Service. Foreign Agricultural Trade of the United States. Washington, D.C. Various Issues.

China has participated in two USDA agricultural export promotion programs in recent years: EEP and the Market Promotion Program (MPP--until 1990, this program was known as the Target Export Assistance [TEA] program).

However, China has never imported U.S. commodities under the export credit guarantee programs (GSM-102 and GSM-103). Several months ago, USDA initiated the process of establishing credits for China, but the Chinese government has been somewhat slow to respond. Observers attribute the sluggish pace to Chinese domestic political and economic factors. China's eligibility to participate in the P.L. 480 concessional sales program has not been determined by any Administration.[2]

Since 1987, when China first became eligible for EEP commodities, it has imported over 28 million metric tons of EEP-subsidized wheat. From fiscal year 1986 through 1993, over $2 million in TEA and MPP funds have been used to promote in China nearly $5 billion worth of American farm exports, including grain, plywood, seed, table grapes, ginseng, meat and meat by-products, tobacco, and wine. (Comparable value data on EEP are not available.) One USDA official also noted that, during the same period, much of the $44 million spent on U.S. farm product promotion (assisting nearly $5 billion in agricultural exports) in Hong Kong also has indirectly boosted sales to China, because of the heavy trade between Hong Kong and the mainland.

THE U.S. WHEAT SECTOR AND CHINA'S MFN STATUS[3]

To assess the possible economic consequences for the U.S. wheat sector of a denial of MFN status to China, the WEFA Group examined two contrasting scenarios; the firm forecasted the economic impact of a continuation of the current level of wheat trade with the likely effects of a complete cessation of wheat exports to China; essentially WEFA compared the status quo with the worst-case scenario. The results are summarized in table 3 (on page 6).

The first scenario--China continues purchasing at current levels--assumes that China's MFN status will be extended, and that China will continue to be a significant buyer of American wheat. In an alternative scenario, WEFA assumed that China would be denied MFN status this year and would retaliate by not importing *any* wheat from the United States for the next three years, a scenario perhaps made more possible by the existence of China's large grain stocks.

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[2] Congress gave the President the authority to designate China as a "friendly country" and to determine whether China satisfies the criteria for participating in the P.L. 480 Title I program. U.S. Congress. Senate. Report of the Committee on Foreign Relations, International Security Enhancement Act of 1982, 97th Congress, 2d session, May 1982, pp. 38-39.

[3] The estimates in this section were calculated upon CRS request by the WEFA Group, an economic consulting firm located in Bala Cynwyd, Pennsylvania. Hereafter, the term *year* will refer to the June-May wheat marketing year.

It is important to note that other wheat exporting countries hold enough wheat stocks to fill China's lost supplies from the United States, should China choose to reject U.S. wheat exports altogether. Thus, while trading patterns would likely change over the long run, the other countries could satisfy China's typical demand from the U.S. for the next three years.

The WEFA analysis examined the direct effect on wheat prices of lost sales to China, as well as the secondary effects on livestock production, USDA wheat program payments, and overall farm income. Assuming all other things remained equal, the analysis indicates that if China were denied MFN and responded by declining to purchase any wheat from the United States, the U.S. wheat sector in the 1994 marketing year would experience a loss of about 81.5 million bushels in export sales. In 1995 and 1996, estimated export losses under the no China sales scenario are at about 83.7 and 81.5 million bushels, respectively.

According to WEFA, if China stopped purchasing U.S. wheat, the resulting weaker demand and larger U.S. stocks could combine to depress U.S. wheat prices by about 3 cents per bushel by 1994, 9 cents per bushel in 1995, and 15 cents per bushel in 1996. In addition, the psychological effect of losing a major foreign wheat market might tend to push U.S. prices down even further in the future. However, lower feed prices might improve livestock production profitability and encourage more meat production in the United States. The model assumed that there would be no difference in acreage reduction programs (ARP) under the extended MFN scenario. The rising carryover stocks and increasing budget exposure might encourage USDA to raise the wheat ARP in 1995 or 1996.

WEFA predicted that net farm income would decline, but by less than $100 million each year, if China were to stop buying U.S. wheat. Food grains cash receipts would decrease, but might be offset by increased profitability in the livestock sector and higher Government payments. The consulting firm predicted that direct Government wheat payments will be approximately $220 million higher over the three-year period if MFN were not granted and China retaliated against the U.S. wheat sector.

Table 3: U.S. Wheat and MFN for China

	1992	1993	1994	1995	1996
Baseline (MFN, Continued U.S. Wheat Exports)					
Exports (mil. bu.)	1353.6	1227.2	1259.8	1270.2	1297.6
Farm Price ($/bu.)	3.23	3.2	3.22	3.15	3
Food Grains Cash Receipts (Billion $)	8.9	7.9	8.6	8.7	8.4
USDA Wheat Payments (Billion $)	1.42	1.91	1.96	1.83	2.81
Net Farm Income (Billion $)	48.6	46.6	44.7	46.6	47.3
	1992	1993	1994	1995	1996
Alternative (No MFN, No U.S. Wheat Export to China)					
Exports (mil. bu.)	1353.6	1227.2	1178.3	1186.5	1216.1
Farm Price ($/bu.)	3.23	3.2	3.19	3.06	2.85
Food Grains Cash Receipts (Billion $)	8.9	7.9	8.5	8.5	7.9
USDA Wheat Payments (Billion $)	1.42	1.91	2.08	2.08	2.22
Net Farm Income (Billion $)	48.6	46.6	44.7	46.6	47.3

SOURCE: WEFA